43. Some petitioners also argue that an inclusive interpretation of equipment subject to the "actual cost" standard will stifle technological development in subscriber equipment. They claim that this interpretation will discourage innovation by depriving manufacturers and cable operators of the financial rewards commensurate with the risks inherent in the design and development of advanced equipment. Cablevision further asserts that the Commission's failure to exempt from rate regulation converters that add incremental features unrelated to the receipt of cable services, such as handsets for personal communications services and facsimile machines, frustrates the public policy goals of promoting innovation and investment in the design and development of advanced converters and is inconsistent with the Commission's policy with respect to common carriers of permitting the offering of customer premises equipment (CPE) on a deregulated basis.

44. We remain convinced that our regulatory scheme will not stifle technological development. Cable operators are entitled under this section of the Act to recover their costs, and earn a reasonable profit, for any equipment used to receive the basic tier. The revenues they receive thus should approximate their revenues in a competitive market. There is nothing in the record -- nor in the Commission's experience -- which suggests that equipment manufacturers and cable operators need to be able to charge higher than competitive rates in order to develop innovative equipment. To the contrary, this Commission has long held that competition is a spur to technological development, not a hindrance. Moreover, even if a specified piece of equipment is subject to regulation, any services provided using that equipment other than basic service or cable programming services, whether cable-related or not, remain unregulated. Cable operators thus have the option of using revenue derived from unregulated services to cover any equipment-related costs that they do not wish to recover through equipment charges. As noted in the Rate Order, nothing in the Cable Act prevents a cable operator from offering equipment below cost to encourage its use.[72]

45. A number of petitioners argue that where a competitive market for similar equipment exists within the franchise area, such equipment should be unregulated. They contend that this approach is consistent with Congress' intent to rely on the competitive marketplace to the extent feasible, citing Section

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[72] Most technological development in such equipment is conducted by companies that do not own cable systems. See, e.g., Scully, "Cable converters entering new era," Broadcasting & Cable, June 14, 1993, at 79. Under the regulations, cable operators can pass on to their subscribers the full cost of buying such technologically advanced equipment from these companies.

2(b)(2) of the 1992 Cable Act. In opposition, GTE approves of the regulations, asserting that, if properly executed, they will lead to the kind of competition that has emerged in the telephone industry in installation, maintenance, repair, and lease/purchase of equipment.

46. These petitioners merely reiterate arguments considered in the initial decision not to establish a separate effective competition test for equipment, and that decision is affirmed. The Rate Order indicated that the information necessary to establish an effective competition test for equipment and installation is not available at this time, and the petitioners have not provided additional information with respect to creating a standard for determining when the market is competitive. The Commission, recognizing that competition for cable equipment technologies is evolving, will continue to monitor the marketplace and will reexamine this issue at an appropriate time.[73]

2. Application of the Actual Cost Standard

47. Section 623(b)(3) of the Communications Act requires that the rates for equipment and installation used to receive basic service reflect their actual cost. In order to determine the actual cost of equipment and installations, cable operators must unbundle each piece of equipment and must separate equipment from installation.[74] They also must utilize a specific methodology for determining the actual cost of each piece of equipment and installation.[75] Under this methodology, the cable operator must establish an Equipment Basket to which it assigns the direct costs of service installation, additional outlets, and leasing and repairing equipment. In the Equipment Basket, the cable operator must allocate the system's joint and common costs that service installation, leasing, and equipment repair share with other system activities (but not general system overhead), plus a reasonable profit. The guidelines that cable operators

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[73] The Commission is considering how to make available to consumers, either through sale or lease, a variety of equipment that will be compatible with equipment provided by cable operators and will include some equipment designed to compete with that provided by cable operators. See Notice of Inquiry in ET Docket No. 93-7, (Implementation of Section 17 of the Cable Television Consumer Protection and Competition Act of 1992, Compatibility Between Cable Systems and Consumer Electronics Equipment), 8 FCC Rcd 725 (1993).

[74] 47 C.F.R. § 76.923(b). See Rate Order at paras. 287-288, 294-298.

[75] 47 C.F.R. § 76.923(d)-(g).

must follow to calculate these actual costs are set forth in FCC Form 393, Part III.[76] Cable operators must also unbundle and apply this actual cost standard to cable programming service equipment and installations to determine whether charges for these items are not unreasonable as required by Section 623(c).[77]

48. NCTA and several cable operators seek reconsideration of the decision to require unbundling and to apply the same actual cost methodology to equipment and installation charges for the basic service tier and for cable programming services.[78] They argue that cable service and equipment are interdependent goods and bundling should be permitted. NCTA and others ask that the Commission allow equipment and installation charges for cable programming services to be above actual costs, as long as overall rates are reasonable, stating that such subsidization will allow cable operators to offer a low cost basic service.

49. These parties merely restate the argument disposed of in the Rate Order that Section 623(c) of the Communications Act sets forth a "not unreasonable" rate standard for cable programming services, including equipment and installation, as opposed to the "actual cost" requirement for the basic service tier, found in Section 623(b). In developing a comprehensive regulatory scheme for rate regulation, however, a tier-neutral benchmark approach was found to best fulfill the stated goals of the Cable Act.[79] Consistent with that decision, the programming portion of cable programming service is subject to the same benchmarks as basic tier programming. Since Congress defined this service with an equipment and installation component, we concluded that an actual cost standard is most appropriate for determining equipment and installation charges, notwithstanding the discretion afforded to select an alternative approach. Although this fundamental decision has been challenged on reconsideration, petitioners have failed to present any alternative methodology we might use when evaluating whether the rates for cable programming service equipment are "not unreasonable." Accordingly, we affirm our decision to use the actual cost standard to measure the reasonableness of rates for cable programming service equipment and installations. This

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[76] Petitions for reconsideration and clarifications relating to the guidelines and specific elements of Form 393 are discussed below.

[77] 47 C.F.R. § 76.922(a).

[78] No petitions for reconsideration address the decisions regarding the unbundling and use of an actual cost standard for the basic service tier.

[79] Rate Order at paras. 396-97.

standard will protect consumers from unreasonable rates and at the same time permit cable operators to earn revenues comparable to those that could be gained in a competitive environment.[80]

50. Petitioners' argument that we not require unbundling of equipment and program service charges also was fully analyzed and rejected in the Rate Order. As we discussed in that decision, an unbundling requirement is the most effective means of ensuring that rates for program services and rates for consumer equipment each meet the separate standards of reasonableness set forth in the 1992 Cable Act and the Commission's Rules.[81] In addition, an unbundling requirement best addresses Congress' concerns that bundling practices have played a significant role in enhancing cable's market power.[82] In view of the petitioners' failure to raise new and persuasive arguments on this issue, we affirm our decision to require the unbundling of program service and equipment rates.

51. Time Warner seeks reconsideration of the decision to apply the actual cost standard to the sale of equipment. It argues that the statute does not address this matter and that the Commission is not empowered to establish such rate regulation. Further, Time Warner contends, this action is not in the public interest, since a competitive market exists for the equipment available for sale. Whether the requirements of Section 623(b)(3) for establishing a "price or rate" for "installation and lease of equipment" includes the sale of such equipment is unclear. However, we decline to exempt from regulation sales of equipment if to do so would merely create a loophole that would allow cable operators to avoid our equipment rules. Section 623(h) empowers the Commission to prevent evasions of our rules, which we believe could occur if operators were free to convert leasing arrangements to "installment sales contracts" and thereby avoid regulation of equipment rates. On the other hand, there is no need for the Commission to regulate the sale of equipment where comparable equipment is available from operators on a leased -- and regulated -- basis. Therefore, we conclude that equipment sales by an operator will be unregulated where the operator offers subscribers the same equipment under regulated leased rates.

3. Additional Connections

52. Section 623(b)(3)(B) of the Communications Act

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[80] A competitive rate is generally one that reflects actual cost including a reasonable profit.

[81] Rate Order, at paras. 287-88 and 410-412.

[82] Id. at para. 411-12.

requires the Commission to establish rate standards, on the basis of actual costs, for installation and monthly use of connections for additional television receivers. The Rate Order stated that the costs associated with additional connections should be included in the Equipment Basket and that operators should recover such costs in the related equipment and installation charges.[83] Equipment and installation charges for additional connections are to be calculated in a manner similar to that prescribed for the primary cable outlet, although it is expected that there will be a smaller charge for installing an additional connection that does not require a separate visit to the subscriber's home.[84] In addition, a cable operator is permitted to recover additional charges, through a monthly charge limited to the operator's additional programming costs, for programming it transmits to additional outlets. Any network costs incurred to facilitate the provision of multiple outlets to subscribers is treated as general system overhead and is to be recovered through program service rates.

53. Several cable operators request that the rules be modified to permit monthly service charges for additional outlets beyond the lease of the additional equipment needed to receive cable service at these additional connections. Parties contend that the Commission erred in interpreting the statute and legislative history to limit additional outlet charges to cover only the lease of the needed equipment. They argue that this approach prevents operators from charging subscribers for the value inherent in the discretionary option of having cable service available at additional outlets. Others, however, argue that where Congress intended for the actual cost standard to apply only to equipment it specifically so stated, and, thus, value-based monthly service charges are not intended for additional connections.

54. The petitioners have raised no new arguments and the Commission's interpretation in the Rate Order of Section 623(b)(3) of the Communication Act, which sets forth the items to be regulated on the basis of actual cost, is affirmed. In paragraph (A) of Section 623(b)(3), equipment is specifically mentioned, while in paragraph (B) of that section the relevant term is "monthly use of connections for additional television receivers" (emphasis supplied). In light of the difference in terminology, it appears that monthly use of connections denotes the receipt of the service at additional home outlets. Thus, there seems to be no basis in the statute for allowing cable operators to charge for the "value" of additional connections

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[83] Rate Order at paras. 306-07.

[84] 47 C.F.R. § 76.923(h).

above and beyond their actual costs.[65] The Rate Order determined that the best method for recovery of such costs is through related equipment and installation charges.[66] Operators may also charge subscribers for any additional programming costs they incur when providing services to additional outlets. In addition, revenue from equipment, including that from additional outlets, was added into the revenue from cable service to determine the rate per-channel that is the basis for the benchmark measurements. The revenue previously received from additional outlets will, under the benchmark regime, now come from per-channel charges for cable service. Therefore, there is an opportunity for cable operators to continue to earn such revenues under the benchmark approach.[67]

55. Petitioners also state that the Commission failed to take into account the costs incurred in designing a cable system capable of providing a signal strong enough to serve multiple outlets in a home. In particular, Time Warner asserts that cable networks have been designed to accommodate an expected number of additional outlet requests, a number that is likely to rise significantly beyond the capability of existing networks if this service must be offered at cost. These cable operators argue that they should have a means to recover the costs of these needed network improvements without the burden of cost-of-service showings. In this regard, Arizona recommends that the Commission permit cable operators to recover the costs of providing additional connections through a modest monthly charge that represents a percentage of the capital expenditures for the network, the capital costs involved with providing the additional outlet and the costs of maintenance of such outlets.

56. Petitioners' claim that their networks are not currently designed to accommodate the increased number of additional connections that will be requested is not substantiated with evidence in the record of this proceeding. Moreover, no party has provided sufficient information upon which we could determine an allowance based on current incremental

[65] Moreover, even if operators could charge for such value, they do not propose any methodology for determining a reasonable rate based on value.

[66] Rate Order at para. 306.

[67] Because per channel and per program offerings are completely unregulated under the 1992 Act, a cable operator may offer such unregulated programming services at rates that vary with the number of outlets that receive such services in an individual subscribing household.

system costs or future costs resulting from increased demand.[illegible] Thus, until the demand for additional connections unable to be accommodated is known, no further consideration of this matter is needed. The rules, in general, provide a means to examine individual cases, including through a cost-of-service proceeding. Moreover, should parties provide evidence at a later date to substantiate their claims, the Commission can reevaluate the situation.

4. Guidelines for Determining Equipment and Installation Charges

57. The Commission developed Part III of FCC Form 393 to provide the methodology for calculating the actual costs of equipment and installation charges for cable service in the Equipment Basket. A number of reconsideration petitions address the general guidelines for determining actual cost. Some petitioners also seek modifications of the form or request clarifications regarding its use. In addition, a number of questions relating to the calculation of the actual cost of equipment and installations have arisen since the adoption of the Rate Order.[illegible] Several of these issues are addressed in turn below.

58. Some cable interests argue that the permitted rate of return of 11.25 percent is too low and has no basis other than its use as the rate allowed local telephone exchange carriers. As evidence that a higher rate is justified, Booth America observes that the average bond yield over the past two years for the cable industry set by the investment community is higher than comparable bonds for local telephone exchange carriers (8-15 percent vs. 7-9 percent). The relative bond yields for different industries, however, is not necessarily correlative to the reasonable rates of return for the regulated segments of those industries. The choice of an 11.25 percent rate of return for regulated cable equipment was based on the Commission's

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[illegible] Our methodology already accounts for each of the costs that Arizona lists. In addition to the network costs that should be recovered through program service rates set pursuant to the benchmark, the capital costs associated with the additional outlets and the costs of maintenance are reflected in our actual cost standard for equipment and installations.

[illegible] A Public Notice released July 30, 1993 addressed a number of these questions. See Cable Television Rate Regulation, Questions and Answers Relating to FCC Form 393, Public Notice, July 30, 1993. The relevant answers are repeated here.

experience in rate making."[90] However, the allowed rate of return can be adjusted by the Commission, if the current provision proves to be unfair to either cable operators or to ratepayers. Further, cable operators may apply the rate of return at a rate "grossed up" for income taxes,[91] and the instructions for the calculation of income taxes includable in Column G of Schedules A and C have been revised to reflect this change.

59. A number of cable operators state that the actual cost methodology does not recognize the costs of tax liability attributable to partnerships, Subchapter S corporations and sole proprietorships.[92] They observe that these taxes are not paid by

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[90] In the pending cost of service rate proceeding, the Commission proposed a rate of return range between 10 and 14 percent based on its analysis of the cost of debt and equity in the cable industry. See Notice of Proposed Rulemaking in MM Docket No. 93-215, FCC 93-353, released July 16, 1993, at paras. 46-56.

[91] The federal tax rate of 34%, for example, would be grossed up to 51.5%, calculated as 34 / (100 - 34). Or, the 11.25% rate of return would be grossed up to 17.04% to include federal taxes, calculated similarly as 11.25 / (100 - 34).

[92] Our provision to gross-up the return amount for income taxes applies to all tax paying business entities to the extent that they have a state or federal income tax obligation. All other taxes, including gross receipt taxes, property taxes, and franchise taxes are includable in the cost of service for all entities. Sole proprietors, partners, and Subchapter S corporation (S corporation) shareholders pay only one tax on the earnings they have from their interest in business entities. A sole proprietor does not have an income tax obligation separate from the income tax payable by the individual owner. The income from business is included in the individual return and taxes paid at the individual tax rates. While a partnership files a return, it is not a tax-paying entity. The partnership's income, deductions, and credits are passed through to the partners and are given tax effect on their individual returns at individual tax rates. The S corporation is treated more like a partnership than a corporation for income tax purposes in that it is generally exempt from all federal income taxes. (To the extent that it does pay income taxes, such payment is on passive investment items which generally are not beneficial to ratepayers. To the extent that such tax, or any similar income tax, is on items demonstrably beneficial to ratepayers, we would allow inclusion of such payments in a rate of return filing.) Partnership-like rules allow the pass through of income and loss items to the S corporation shareholders who pay the taxes at individual tax rates. A distribution of earnings to shareholders is treated as a return of shareholders' investment upon which no tax is payable. In contrast to all of the above, a regular

the operator, but by the ultimate owners. However, they claim that these taxes are legitimate costs of providing equipment and services and should be recoverable. These petitioners, however, misconstrue the workings and purposes of these provisions. All taxes, including income taxes for those business entities required to pay income taxes, are taken into account in our actual cost methodology. The provision for income taxes is made to compensate the business entity for a cost of doing business and to allow it thereby to earn a fair after-tax return on investment. Any business with a statutory income tax obligation thus may include the cost of such obligation in its rate calculations. However, because Subchapter S corporations, partnerships, and sole proprietorships do not have an income tax obligation as business entities, this provision is not applicable to them. Accordingly, such entities that do not have income tax obligations would enter zero in Column D of Schedules A and C. For corporations with income tax obligations, the amount included in Column D is based on the "grossed-up" statutory rates, not the tax rate actually paid.

60. Arizona asserts that the methodology for determining monthly equipment charges depends on the extent to which equipment has been depreciated. It claims the original cost cannot be recovered over its remaining useful life in some situations and suggests that cable operators be allowed to calculate the monthly equipment lease charge using a *pro forma* methodology that permits recovery of original costs. Baraff states that Form 393 appears to permit an operator to include equipment and service not previously offered.[93] However, it

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corporation (C corporation) is a tax-paying entity. And while our intent is not to grant relief for double taxation, the fundamental difference with respect to income taxes between a C corporation and these other entities is readily observed in the fact that C corporation owners effectively pay two taxes on business entity profits, once at the corporate level and a second time at the individual level on the dividends received. Sole proprietors, partners, and S corporation owners pay one tax only and that at the individual level.

[93] Baraff also states that Line 104 requires all equipment revenue to be included, even though the inclusion of revenues from unregulated services artificially inflates the regulated rate. The Line 104 instructions, however, are correct as stated because they are consistent with our methodology for calculating the benchmark. While it might have been preferable to have calculated the benchmarks with the unregulated equipment revenues excluded, the data used to establish the benchmarks did not include the necessary information to proceed in this manner. Moreover, because the benchmarks included revenue from unregulated equipment, they too are "artificially inflated" under Baraff's approach. Thus, any

observes that the form relies on historical data for determining a permitted rate and seeks clarification that an operator may use prospective costs where it anticipates offering new equipment.

61. The methodology specified for development of rates for leased equipment is dependent to an extent on the amount of accumulated depreciation associated with each equipment type. This is necessarily so because it is assumed that recovery has already been attained for that portion of plant for which depreciation has been taken and no provision should be made for recovery beyond the cost of the plant. This assumption is founded on the expectation that operators use standard accounting practices, which would employ depreciation lives commensurate with the economic productivity of assets and would thus match the costs of the plant with the revenues generated by the use of such plant.

62. The equipment rates, however, are not dependent on the accumulated depreciation balance alone. As a result, the rates for one operator with a higher proportion of accumulated depreciation will not necessarily be lower than another operator with a lower proportion of depreciation. For example, if all factors except age are equal, including original cost and useful life of equipment, the rates should be the same for both operators. The one with the newer equipment and, therefore, lower accumulated depreciation will simply be allowed to charge customers for a longer period until full recovery is attained.

63. To the extent that systems have failed to recover amounts now reflected in accumulated depreciation, the amount would be reflected in the system's accumulated loss. It is recognized that the failure to make recovery and the accumulation of losses result from policies involving business strategies put in place before the introduction of regulation. Comment has been sought on the need to make special provision for such losses in a separate cost of service proceeding.[94] Whatever the result of that inquiry, the procedures for rate development for equipment should apply sound ratemaking principles and assume good accounting practices. Recovery of past shortfalls will be considered as a separate item.

64. In establishing the rules for the pricing of equipment, we intended that operators would have a methodology

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harm to operators that may have been caused by including unregulated equipment revenues when calculating a system's actual rate is offset by the fact that such revenues were also included in the benchmark calculations.

[94] Notice of Proposed Rulemaking in MM Docket No. 93-215, FCC 93-353, released July 16, 1993, at fn. 44.

for pricing leased equipment in such a way that would effectively allow recovery of full cost over the equipment life. In theory, then, a piece of equipment would be fully paid for just when it is ready for retirement and new equipment must be installed. Recalculation of rates for each equipment type is allowed annually and customer charges should be adjusted up or down based on the recalculation. As newer models are employed, a separate rate shall be developed. In such case, when the new model is introduced during the interim, a rate may be calculated and used until the annual recalculation is made. Alternatively, however, where the operator expects eventually to replace the older model upon retirement with a newer model that is not significantly different, operators may phase the new equipment in by developing a weighted average rate for both the new and old items.[95]

65. A few petitioners request clarification or modification to allow use of data averaged on a system-wide or accounting unit basis throughout Form 393, not just in selected places, to alleviate some of the burdens of completing the form. Form 393 does not actually specify the level of averaging that is allowed or required for equipment costs. The form is designed, however, to develop rates for each franchise within an operator's system. We clarify that the allocation of equipment costs to the franchise level may reflect averaging to the extent permitted by the cost accounting and allocation provisions of Section 76.924 of our rules.[96]

66. While not raised specifically in the petitions, several other matters need to be explained or clarified. Lost converters should not require separate consideration in the calculation of equipment rates inasmuch as the depreciation rates may take into account a normal loss, and retirement of such lost items will adjust the net plant balance. To the extent that there is an unusual number of lost items which is not provided for in depreciation rates, a reasonable adjustment may be made to

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[95] Specifically, under Section 76.923 of our rules, operators are required to separate charges for each significantly different type of remote, converter box and installation. An operator may establish one charge for all other customer equipment or develop independent charges for specified other equipment. <u>See Rate Order</u> at para. 288.

[96] In Section 76.924(d) of our rules, we stated that "cable operators shall aggregate expenses and revenues at either the franchise, system, regional, or company level in a manner consistent with practices of the operator as of April 3, 1992." We clarify here that this rule also applies to equipment and installation costs.

recover the cost.[87] Likewise, unusual maintenance may not be adequately provided for. For instance, where a company sends one equipment type out for repair instead of doing the work itself, such amount will be averaged over all equipment types if the expense is included on Schedule B. To remedy this, the expense should be included on Schedule C, Column H with notation and documentation. This will ensure that the cost is averaged over the specific equipment type only and not over all equipment.

67. Annual recalculations of equipment costs should be based on the annual data for the operator's previous fiscal year. When, however, there has been an unusual change in operations that would not be adequately reflected in the previous year's annual data, subject to acceptance by the local franchising authority, or by the FCC when applicable, a representative month may be used for the calculation of rates. Further, when there would be no material difference in results from using a representative month rather than the past fiscal year, and where the local franchise authority, or the FCC when applicable, finds it acceptable, a representative month may be used. In both cases, the operator should attach a brief statement to Form 393 explaining why it is appropriate to use a representative month.

68. The equipment calculations provide that the cost of maintaining equipment is to be included in the charge made for the equipment. Accordingly, there should not also be a separate charge made to customers for service calls to maintain company owned equipment on customers' premises.

69. The charge for service installation is to be calculated on the basis of the hourly service charge (HSC). This charge includes the direct labor as well as the capital costs of the service installations as determined on Schedule A of Form 393, Part III. Consistent with our determination to unbundle installation and equipment charges in the Rate Order, it does not include the cost of material for the drop, connections, inside wire, or other equipment installed.[88] These items are either

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[87] Local franchising authorities should be able to assess the reasonableness of such adjustments. Where recovery over the next year will not cause unusual rate spikes, an adjustment can be made by including such unusual losses in the depreciation expense reported on Schedule C, Column H. In such case the amount included for unusual losses should be noted and documented. Where an unusual rate spike would occur, the recovery should be made by deferring the loss for ratemaking purposes and amortising the amount over a long enough period to smooth out the rate effect, such as over the average remaining life for the equipment in question.

[88] Rate Order, at para. 288.

capitalized as distribution plant or separately chargeable to customers in equipment prices. The installation labor may include all labor from the drop inward, including the cost of labor to install the drop and connections."[99] Since the cost of the drop material is capitalizable as distribution plant, the expected maintenance to the drop over its useful life shall not be included in the installation charge. Installations are not to be capitalized and are, therefore, not includable on Schedule C of Form 393, Part III. Finally, the installation charge may be a one time charge or set up in installments.[100]

F. PROCEDURAL AND JURISDICTIONAL ISSUES

1. Preemption of Franchise Agreements Barring Rate Regulation

70. The Rate Order stated that the 1992 Cable Act preempts provisions in existing franchising agreements barring rate regulation by franchising authorities.[101] It cited the House Report which stated that all franchising authorities, regardless of preexisting provisions in a franchise agreement, now have the right to regulate basic cable service rates if they meet the certification requirements.[102] In this regard, it noted that Congress would not have expressly grandfathered specific types of rate regulation agreements in Section 623(j) of the Communications Act had it intended that any other rate regulation

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[99] In the Rate Order, we stated that operators could charge for installations on the basis of the HSC times the actual person hours of the visit. This provision recognized that the cost of installations could vary depending on the length of the drop. It was noted that basing the charge on the person hours per visit would recognize the cost differential while precluding the need for surcharges. Alternatively, however, we permitted cable operators to base the installation charge on the HSC times the average hours spent per installation visit. Consistent with this alternative, it would also be acceptable to exclude labor associated with all drops from customer installation charges and to capitalize the labor as part of the cost of the drop. Rate Order at para. 298.

[100] Operators may also sell service contracts on such equipment. The price of these contracts shall be based on the HSC times the estimated average number of hours required for maintenance and repair over the expected life of the equipment. Rate Order at para. 298.

[101] Rate Order at para. 61.

[102] Rate Order at para. 60.

agreements would continue in force and effect.[103]

71. One petitioner, representing cable interests, requests that the Commission allow cable operators and franchising authorities to enter into new agreements under which local authorities would forbear regulation. This petitioner contends that such agreements serve the public interest to the extent that a franchising authority may negotiate benefits such as upgrades and expanded service areas, or where it determines that it can make better use of its franchise fees than in costly rate regulation. The petitioner proposes that such agreements may not be conditioned on some alternate form of rate regulation, and that they permit the franchising authority to seek certification if the cable operator breaches the agreement. Another group of cable operators asserts that such agreements would reduce the number of Commission cost-of-service proceedings and appeals of local cost-of-service proceedings, as well as permit negotiation for service options that may not be easily obtained without cost-of-service showings.

72. We believe that the types of arrangements described by the petitioners are not permitted under the Act. As the Conference Report stated the goal of Section 623(a) of the Communications Act "is to protect subscribers of any cable system that is not subject to effective competition from rates that exceed the rates that would be charged if such a system were subject to effective competition."[104] It is apparent that Congress did not intend to permit local franchising authorities to bargain away this statutory protection for local subscribers in exchange for some other related or wholly unrelated benefit, whether perceived or actual.[105] Under the current regulatory scheme, a franchising authority that does not believe rate regulation is necessary may simply choose not to seek certification from the Commission. The franchising authority may conclude, for instance, that the cable operator's basic rate is reasonable and its service satisfactory, or the franchise fee may be earmarked for other governmental purposes. As stated in the Rate Order, the Commission will not assume jurisdiction at this time where a franchising authority does not apply for

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[103] Id. at para. 61.

[104] Conference Report at 62.

[105] An agreement to regulate rates in a manner inconsistent with Commission rules is, in any event, squarely prohibited by Section 623(a)(3)(A) of the Communications Act. See also Rate Order at para. 471. Similarly, neither cable operators nor franchising authorities are permitted to reach "off the books" agreements that affect, or are inconsistent with, local or federal obligations under the Cable Act.

certification.[106] Such a decision by the franchising authority, however, does not and cannot preclude it from seeking certification in the future if circumstances warrant local rate regulation.

2. Cable Operator Responses to Cable Programming Services Complaints

73. Section 623(c)(1)(B) of the Communications Act requires the Commission to establish "fair and expeditious procedures for the receipt, consideration and resolution of complaints" regarding cable programming services. Section 623(c)(3) provides that, with the exception of complaints filed during the 180-day period following the effective date of our rules, cable programming service complaints must be filed within "a reasonable period of time" following a change in rates, including a change in rates resulting from a tiering change. The Rate Order interpreted "reasonable period of time" as 45 days from the time a subscriber receives a bill from the cable operator that reflects the rate increase.[107] The Rate Order also determined that the complainant must supply certain readily available factual information to make a "minimum showing," on a standard complaint form, to receive adjudication of the complaint.[108] Complaints that fail initially to meet the minimum showing requirement will be dismissed without prejudice and the complainant will be given one additional opportunity to file a corrected complaint.[109] Absent a Commission notification that the complaint fails to make the minimum showing, the cable operator must respond within 30 days from the date of service.[110] A cable operator failing to file and serve a response to a valid complaint may be deemed in default, and an order may be entered against the cable operator finding the rate in question to be unreasonable and mandating appropriate relief.[111]

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[106] Rate Order at para. 54; see also id. at para. 53 n.166. A franchising authority, however, may request the Commission to regulate basic service rates in its community if it is unable to do so under the statute and our rules. Rate Order at para. 55.

[107] Rate Order at para. 333.

[108] Id. at paras. 339, 340. The complainant must allege simply that a rate for cable programming service or associated equipment charged by the cable operator is unreasonable because it violates the Commission's rate regulations.

[109] Id.

[110] Id. at para. 356.

[111] Id.

74. Certain cable operators argue that the Commission should first determine whether a complaint is meritorious before the operator is obligated to respond. Petitioners contend that the burden should not be placed on the cable operator to respond in 30 days if the Commission is unable to dismiss frivolous complaints within that time period. They argue that if the Commission does not first determine that a complaint fails to meet the minimal requirements, then the cable operator should be able to respond simply that the complaint is deficient and not be required to justify its rates.

75. We believe that cable programming service complaint procedures adopted in the Rate Order effectively implement the statutory mandate. With respect to patently defective complaints, Commission processing should eliminate such complaints within 30 days, prior to an operator's response.[112] If petitioners mean to implicate complaints that are not patently defective, they would seem to transform the subscriber's "minimum showing" requirement into a *prima facie* showing requirement, which would be in direct contradiction to the purpose of Section 623.[113] Petitioners' proposal would also delay Commission consideration of the subscriber's complaint, because the subscriber and the Commission would ultimately wait longer for the cable operator's substantive response before the rates could be considered. As a practical matter, the cable operator, not the subscriber, is privy to the information that will support its rates. Moreover, most cable operators can be expected to have already performed a benchmark calculation to some level of precision in setting their rates. The 30-day time period for cable operator responses to a cable programming services complaint (unless dismissal occurs during that period) thus sufficiently addresses the Commission's ability to review the complaints in a complete and timely fashion, while preserving congressional intent to place a minimal burden on subscribers.

3. Refund Liability Pursuant to Unsuccessful Effective Competition Challenge

76. The Rate Order stated that a cable operator may file a petition for reconsideration of the franchising authority's

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[112] A "patently defective" complaint is one which omits answers called for in the standard complaint form. Such defective complaints will be dismissed without prejudice, with an opportunity for correction within 30 days of notification. The Commission can make this determination even before reaching the merits as to whether the complaint makes the "minimum showing" described in the Rate Order at para. 341.

[113] See Rate Order at para. 339.

certification within 30 days after the certification is granted.[114] It also stated that if the petition for reconsideration challenges the presumption that effective competition is absent, rate regulation will be automatically stayed until resolution of the petition.[115] If the petition is resolved in the franchising authority's favor, *i.e.*, no effective competition is found, the cable operator would be subject to refund liability back to the date the petition was filed.[116] The Commission adopted this procedure to protect the rights of cable operators to be free of rate regulation in the event effective competition does exist, while ensuring that subscribers receive compensation for any overages charged during the pendency of an ultimately unsuccessful petition.[117]

77. A number of municipalities contend that refund liability dating back only to the date of filing the petition for reconsideration, if misinterpreted, could encourage cable operators to make such filings regardless of the petition's underlying merits, because it would reduce their refund liability by at least a month, and possibly much longer. This would occur because the cable operator's refund liability goes back potentially to the effective date of the rate rules, *i. e.*, September 1, 1993, for the systems serving most subscribers. If a franchising authority were to seek certification on October 1, 1993, and the cable operator were to challenge that certification request on the basis of effective competition on October 31, 1993, the provision could be read to limit the operator's refund liability to October 31, 1993. This would remove the refund liability for a two-month period, even if the operator were to ultimately lose the effective competition challenge. Petitioners are correct in pointing out this unintended and inappropriate possibility. Therefore, cable operators filing an effective competition challenge will be subject to the same refund liability as all other systems should their challenges prove unsuccessful, and Section 76.911(c)(3) of the Commission's rules is clarified accordingly.

4. Basic Tier Definition

78. Section 3(b)(7)(A) of the 1992 Cable Act provides that the minimum contents of the basic service tier should include: all signals carried in fulfillment of the requirements of

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[114] Rate Order at para. 88.

[115] Id. at paras. 46, 89.

[116] Id. at para. 89; 47 C.F.R. § 76.911(c)(3).

[117] Id. at para. 89.

Sections 614 and 615[118] of the Communications Act; any public, educational, or government access channels required by the franchise; and any signal of any television broadcast station that is provided by the cable operator to any subscriber, except a signal which is secondarily transmitted by a satellite carrier beyond the local service area of such station. The Rate Order stated that this statutory definition of the basic service tier preempted provisions in franchise agreements that require additional services to be carried on the basic tier.[119]

79. A number of municipalities argue that this interpretation is inconsistent with preexisting sections of the Communications Act, added by the 1984 Cable Act, that have not been superseded by the 1992 Cable Act, such as Section 625(a)(1)(B), relating to the modification of existing franchise obligations. Petitioners argue that because this provision permits a franchising authority to prohibit a cable operator from changing the "mix, quality or level" of cable services required in a franchise unless the cable operator demonstrates that such "mix, quality or level" of services remains the same after any modification, a franchising authority could prohibit the retiering of programming from basic to another tier.

80. Petitioners also argue that because Section 624(b)(2)(B) of the Communications Act allows franchising authorities to enforce requirements "for broad categories of video programming or other services," Congress did not intend to preempt preexisting franchise agreements. In any event, they contend, requirements in an existing agreement are those to which the franchising authority and the cable operator have already agreed, and were not imposed unilaterally by the franchising authority.

81. One petitioner argues that the 1992 Cable Act amended the 1984 Cable Act specifically to permit franchising authorities to take into account the number of channels on a tier in deciding whether to renew a franchise. The petitioner points out that, in the 1992 Cable Act, Congress specifically omitted the 1984 Act's prohibition against taking into account the "level" of services for renewal purposes, so that, it argues, franchising authorities now can require a certain level of services, *i.e.*, specify the

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[118] Sections 4 and 5 of the Cable Act contain the must-carry requirements pertaining to commercial and noncommercial television stations, respectively.

[119] Rate Order at para. 161.

number of channels on the basic tier, in renewal negotiations.[120]

82. Petitioners also argue that because Section 625(d) allows cable operators to rearrange service from one tier to another if rates for these tiers are not subject to regulation, the above reasoning is logical only with respect to cable operators <u>not</u> subject to rate regulation. They argue that this provision would be unnecessary if all cable operators could freely move services from one tier to another.

83. In response to these assertions, a number of cable interests argue that the elements of basic service should be at the cable operators' discretion, and not imposed as part of a franchise agreement. As one such petitioner points out, the franchising authority could require so many basic channels that they would control the rates of all satellite-delivered programming services and have the power to control retiering, which would nullify the Commission's sole jurisdiction over cable programming services in Section 623. The municipalities reply that if cable operators have the sole discretion to add satellite-delivered programming to the basic tier, this already eliminates the Commission's sole jurisdiction over those channels.

84. We reaffirm the <u>Rate Order</u>'s preemption of franchise agreements that purport to mandate distribution of additional services on the basic tier beyond the new statutory requirement. The legislative history of the 1992 Cable Act is unequivocal that Congress intended to give cable operators the right to determine the elements of the basic tier, subject to the minimum statutory requirements.[121] We believe that this flexibility is unaffected by the franchising authority's new right to take into account the "level" of services at renewal time. Indeed, the Senate Report

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[120] Petitioner also proposes that, along with this right, would be the enforcement of "lifeline" tier requirements, <u>i.e.</u>, sub-basic tiers designed for senior citizens and economically disadvantaged residents. The Commission has already determined, however, that Congress intended that cable operators have only one basic tier for purposes of the rate regulation provisions of the 1992 Cable Act. <u>Rate Order</u> at para. 170. For the same policy reasons that cable operators would not be able to offer an expanded basic tier in addition to the required basic tier, franchising authorities would not be able to enforce such "sub-basic" tier requirements. Nothing in the Commission's Rules or the 1992 Act, however, prevents an operator from offering its basic service tier to senior citizens and other economically disadvantaged groups at a discounted rate. <u>See generally</u> <u>Rate Order</u> at para. 197 n.500; Communications Act, Section 623(e)(1), 47 U.S.C. Section 543(e)(1).

[121] <u>Rate Order</u> at para. 161 n. 427.

indicates that Section 626 was amended to "allow the franchising authority to consider the level of service provided over the system throughout the franchise term."[122] Thus, it appears that the franchising authority's right to consider the "level" of services does not relate only to the basic tier, or to specific channels, but to the system capacity as a whole.

85. The fact that Congress left Section 625 unchanged suggests that a franchising authority may deny a modification request, based on the franchising authority's determination that the cable operator has changed the "mix, quality and level" of services required by the franchise. But this determination must similarly relate to the system as a whole, not just to the specific composition of the basic tier. Thus, the municipalities have not presented any persuasive arguments that Congress intended to grant them discretion over the basic tier composition.

86. The affirmative authorization in Section 625(d) of the Communications Act for system operators to switch services among unregulated service tiers, although of less import following adoption of the 1992 Act, is not inconsistent with the view expressed in the Rate Order and in the Conference Report that, in the regulated environment, the basic tier is to be composed of the broadcast and access channels specified in the statute and such other services "that the cable operator may choose to provide."[123] While we are bound to take into account the comprehensive statutory scheme, to harmonize, if possible, seemingly contradictory provisions,[124] and to construe the statute in a manner that does not render certain provisions superfluous[125], we must also accord substantial weight to recently-enacted amendments and their legislative history.[126] In this case, that history evinces Congress' intention to displace

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[122] Senate Report at 82 (emphasis supplied).

[123] Conference Report at 60.

[124] Citizens to Save Spencer County v. EPA, 600 F.2d 844, 871-72 (D.C. Cir. 1979) (agency may devise middle course to give maximum effect to both provisions).

[125] U.S. v. Nordic Village, Inc., 112 S.Ct. 1011 (1992).

[126] See May Department Stores Co. v. Smith, 572 F.2d 1275, 1278 (8th Cir. 1978), cert. denied, 439 U.S. 837 (1978) (subsequent amendment and its legislative history entitled to substantial weight in construing earlier law). See also Sutherland Statutory Construction § 22.34 (4th ed.) (where amended and original sections of a statute cannot be harmonized, the new provisions should prevail as the latest declaration of legislative will).

the franchising authority's discretion over the composition of the basic tier. Allowing franchising authorities to continue to enforce service requirements for the basic tier that are well beyond the statutory requirements would clearly compromise Congress's principal concern in enacting the 1992 Cable Act that cable operators provide local services on a basic tier at reasonable rates. Thus, we affirm our prior conclusion that franchising authorities do not have the authority under the Act to require carriage on the basic tier of channels other than those set forth in the statute.[127]

G. THE PRICE CAP GOVERNING CABLE SERVICE RATES

87. In the Rate Order, we determined that rates for regulated cable service would be governed by a price cap mechanism once initial regulated rates were determined either through the benchmark or cost-of-service approaches.[128] Capped rates may be adjusted annually for inflation. In addition, cable operators may pass through to subscribers increases in certain categories of external costs to the extent that such increases exceed inflation: costs of retransmission consent fees incurred after October 6, 1994, other programming cost increases, taxes, and the costs of franchise requirements including PEG access channels. Franchise fees are also accorded external cost treatment.[129] A number of petitioners and responding commenters

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[127] We similarly affirm that franchising authorities may not regulate tier restructuring in a manner that is inconsistent with the 1992 Cable Act. See Communications Act, Sections 623(a)(1), (f), 47 U.S.C. Sections 543(a)(1), (f). In particular, local authorities are precluded from regulating negative option billing to prevent tier restructuring regardless of how the local requirement is characterized. The Commission has ruled that cable operators may engage in revenue-neutral tier restructuring without violating the negative option billing procedure. Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992, Rate Regulation, Order, FCC 93-176, 8 FCC Rcd 2921 (1993), clarified 8 FCC Rcd 2917 (1993).

[128] The Commission selected an annual adjustment measured by the GNP-PI. Rate Order, at para. 223.

[129] See generally 47 C.F.R. §76.922(d)(2)(i) (1993). However, we recognized that the survey data on which the benchmark is based includes all external costs other than franchise fees. We determined that permitting external treatment for the full amount of increases in these costs on top of the automatic inflation adjustment would permit double recovery of those costs that are equal to or less than inflation. Thus, we concluded that for all categories of external costs, other than franchise fees, we will

have expressed concerns about, and/or suggested modifications to, various features of our price cap requirements. We address these concerns and proposals in turn.

1. External Costs

88. General Issues. Several petitioners urge the Commission to adopt suggested overarching criteria for determining eligible categories of external costs. They contend, for example, that operators have substantial bargaining control over programming costs, franchise fees, and other franchise requirements, and that only costs that are beyond the control of the cable operator should be subject to external treatment.[130] Several telephone companies contend that telephone companies subject to price cap requirements can only pass through costs triggered by administrative, legislative, or judicial action beyond the control of the carriers,[131] and that we should limit pass through of external costs to the same extent that we permit telephone companies to do so.[132] Telephone companies also urge that we incorporate a sharing feature in the price cap mechanism for cable service similar to the one that we have included in the price cap rules for telephone carriers.[133] NATOA argues that external treatment should only be accorded to franchise fees because the Commission's benchmark formula generally reflects all costs other than franchise fees and that allowing external treatment for other costs would permit operators to recover such

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permit external treatment for increases in such costs only to the extent they exceed inflation as measured by the GNP-PI. Rate Order, at para. 257.

[130] King County Petition at 4. The petitioner observes that some franchise requirements, such as local programming requirements, may enhance the operator's marketability and subscribership, thereby increasing revenues. Thus, such a requirement may not justify permitting the operator a rate increase. Id.

[131] Bell Atlantic Petition at 5, citing, Policy and Rules Concerning Rates for Dominant Carriers, 5 FCC Rcd 6786, 6807 (1990).

[132] Bell Atlantic Petition at 4-6; BellSouth Petition at 2. They urge that if we do not make external cost treatment for cable companies the same as exogenous cost treatment for telephone companies subject to price cap requirements, then we should amend telephone company price cap requirements to make them comparable to those for cable operators.

[133] Bell Atlantic Petition at 3-4.

costs twice.[134]

89. As indicated, our price cap governing cable service rates accords external cost treatment to costs of retransmission consent fees incurred after October 6, 1994, other programming cost increases, franchise fees, taxes, and the costs of franchise requirements including PEG access channels. We adopted each category of external costs based on the considerations pertaining to the category as discussed in the Rate Order. As modified and clarified below, we believe that these external costs, will permit an initial implementation of cable service rate regulation that will achieve the goals for that regulation expressed in the Rate Order. These categories of costs will broaden cable operators' opportunities to recover the actual changes in such costs, instead of relying on a general inflation adjustment, while at the same time not being so extensive as to undermine the benefits of a price cap mechanism as the primary method of regulation of cable service rates. We will also monitor the impact of these categories of external costs and will modify and refine them as necessary to assure that, as a whole, they will achieve our goals for rate regulation of cable service. For these reasons, we do not find it necessary to adopt the more restrictive overarching standards for determination of external costs sought by some petitioners.

90. More particularly, we do not believe that the cable operators' control over the costs in question should be the exclusive criterion for selection of external costs.[135] Thus, as discussed in the Rate Order, other objectives such as assuring the continued growth of programming diversity may dictate different criteria.[136] Telephone companies have failed to advance a sufficient reason why we should adopt as an overriding policy goal achieving parity in price cap mechanisms for the two industries.[137] Instead, our price cap requirements for cable and telephone services are, and should be, based on the respective, separate considerations discussed in the proceedings in which we adopted those respective requirements. In addition, under the price cap mechanism changes in external costs are compared to inflation. Increases in external costs more than inflation will be reflected in rate increases, and decreases in such costs and

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[134] NATOA Opposition at 12.

[135] Although it can be a factor. See para. 98-102, supra.

[136] Rate Order, para. 251.

[137] It should be noted that the Communications Act continues to state that cable systems "shall not be subject to regulation as a common carrier or utility by reason of providing any cable service." 47 U.S.C. Section 541(c).

increases less than inflation will be reflected in rate reductions. Thus, contrary to NATOA's assertions, there is no double recovery for costs accorded external treatment. For these reasons, we will not change the scope of our external cost treatment.

91. Retransmission Consent Fees. In the Rate Order, we observed that not treating retransmission consent fees as external to the price cap may provide operators the greatest incentive to drive a hard bargain with broadcasters over the value of broadcast signals.[138] However, we recognized that such an approach could risk the non-carriage of broadcast signals if an operator and broadcaster are unable to reach a final agreement regarding a retransmission consent fees.[139] In addition, we concluded that treating retransmission consent fees as external to the price cap would provide greater assurance that broadcast signals are carried because operators could recover these costs through increased rates for cable service. The Commission thus determined that providing external treatment for increases in costs associated with retransmission consent fees best balances these competing interests.[140] However, in order to prevent any sudden increase in subscriber rates due to initial retransmission consent fees, we provided that external treatment for retransmission consent fees would commence after October 6, 1994.[141] External treatment is limited to the new or additional fees beyond those already being charged on that date.[142]

92. Cable operators agree with the Commission's decision to treat costs associated with retransmission consent fees as external to the price cap. However, they dispute the justification for delaying such treatment of retransmission

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[138] Id. at para. 245.

[139] Id.

[140] Id. at para. 246.

[141] See Implementation of the Cable Television Consumer Protection and Competition Act of 1992 - Broadcast Signal Carriage Issues, Rate Order, 8 FCC Rcd 2965 (1993); clarified, FCC 93-284 (released May 28, 1993)("Must Carry/Retransmission Report and Order").

[142] Rate Order, at para. 247. We determined that current rates for cable service, on which the benchmark formula is based, take into account the value of broadcast signals to operators. Thus, as for other external costs except franchise fees, only increases in retransmission consent fees that exceed the price cap may be passed through to subscribers. Rate Order, at paras. 245-47.

consent fees until October 6, 1994, as described above.[143] Blade contends that although operators have long carried broadcast signals, cable service rates historically have not reflected a significant "value" for these signals.[144] If we preclude operators from recouping these costs, Blade threatens to drop a number of broadcast signals demanding retransmission consent fees.[145]

93. We are not persuaded that we should alter the starting date for external cost treatment of retransmission consent fees. As we stated in the Rate Order, delaying the external treatment of retransmission consent fees until that date will protect consumers from abrupt rate increases in response to new retransmission consent arrangements occurring on or after October 6, 1993. We believe that protecting consumers from abrupt rate increases fulfills our statutory mandate[146] and should be accorded greater weight than the fact that retransmission consent fees are new costs to cable operators. Delaying the starting date for external cost treatment for retransmission consent fees also is more likely to encourage cable operators to negotiate a fair price for retransmission consent fees. We do not believe that this will lead to significant numbers of cable operators dropping stations instead of seeking to negotiate a fair price for retransmission consent fees. In addition, as stated in the Rate Order, we believe that cable rates already reflect the value of broadcast signals offered to subscribers. Thus, to some extent, retransmission consent fees merely reflect compensation to broadcasters already received by cable operators from subscribers. Accordingly, we will not alter the starting date for external cost treatment for retransmission consent fees. As we stated in the Rate Order, we will closely monitor initial retransmission consent agreements for their potential impact upon subscriber rates. If additional measures appear necessary to

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[143] See e.g., Booth Petition at 20; Blade Petition at 8-10; NCTA Opposition at 24; Time Warner Petition at 31.

[144] Blade Petition at 9. Time Warner draws a distinction between the "cost" and the "value" of broadcast signals to cable operators. Time Warner states that under competitive conditions, as the benchmark is intended to approximate, competing operators presumably "compete away" the implicit value of broadcast signals. Thus, it argues, these newly required retransmission consent fees constitute new costs to the operator, and should be treated externally from the price cap starting on the initial date of retransmission consent agreements. Time Warner Petition at 32.

[145] Blade Petition at 9.

[146] See Communications Act, Section 623(b)(1), 47 U.S.C. Section 543(b)(1).